Supreme Court of the United States

OCTOBER TERM, 1942.

No. .....

NATIONAL PROTECTIVE INSURANCE COMPANY,
PETITIONER,

VS.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A.

OPINIONS OF THE COURT BELOW.

The opinion of the Circuit Court of Appeals for the Eighth Circuit, filed June 30, 1942, is not as yet officially reported (R. 183-191). The opinion of the United States Board of Tax Appeals, rendered on July 10, 1941, is reported in 44 B. T. A. 978. The opinion of the United States Board of Tax Appeals, rendered on October 2, 1941, on motion for rehearing, is not reported (R. 25-27).

B.

GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED.

The statement of the grounds on which the jurisdiction of this Court is invoked appears as part of the foregoing Petition for Writ of Certiorari (Statement of the Jurisdiction of this Court, *supra*, p. 6 *et seq.*), and is hereby adopted and made a part of this brief.

C.

STATEMENT OF THE CASE.

The statement appears as part of the foregoing Petition for Writ of Certiorari (Summary Statement of the Matter Involved, *supra*, p. 2, *et seq.*), and is adopted and made a part of this brief.

D.

SPECIFICATION OF ERRORS INTENDED TO BE URGED.

(1) The Circuit Court of Appeals erred in holding that the term "total reserve funds," within the meaning of Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711), contemplated all reserves or funds of any kind or character set aside as a matter of "protective business prudence" or for "competitive purposes" (R. 189), and in holding that said term "total reserve funds" included "prudent and applicable reserves" set up by reason of the established necessary and accepted standards for conducting the business, even though such funds or "reserves" were not required by law, had no relation to insurance, were not true insurance reserves and did not meet the standard of true insurance reserves.

(2) The Court erred (R. 189) in holding that petitioner's unearned premium account was a reserve with-

in the meaning of the term "total reserve funds" as used in Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711).

(3) The Court erred in holding (R. 189-191) that the term "reserve funds" in Section 203 (a) (2) of the Revenue Acts of 1934 and 1936, and in Articles 201 (a)-1 and 203 (a) (2)-1 of Treasury Regulations 86, promulgated under the Revenue Act of 1934 and Treasury Regulations 94, promulgated under the Revenue Act of 1936, intended to serve a different purpose than the term "reserve funds" as used in Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711).

(4) The Court erred in holding (R. 189) petitioner's unearned premium account was a reserve within the meaning of the term "total reserve funds" as used in Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711), even though said unearned premium account was not held for the fulfillment of health and accident contracts.

(5) The Court erred in holding in effect (R. 187) that it was the intent of Congress, in enacting Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711), to classify an insurance company as a "life insurance company" or a "company other than life or mutual" by using the measure of the total premium income derived from the two classes of business written by said company rather than measured by the ratio of the insurance reserves held for each class of business.

(6) The Court, upon the basis of facts found by the Board of Tax Appeals and in the agreed statement of evidence, namely (a) that the unearned premium account upon petitioner's health and accident coverage was not based upon a table of contingency or experience; (b)

that said unearned premium account did not take into consideration earnings or interest on the fund; and (c) that said unearned premium account was not used to pay contingent claims when the contingency insured against occurred, erred in holding (R. 189) (a) that petitioner's unearned premium account upon its health and accident coverage was a reserve fund within the meaning of Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711); (b) that the petitioner, for the taxable years 1935 and 1936, held reserve funds maintained on its health and accident coverage which comprised more than fifty per cent of its total reserve funds; (c) that petitioner, for the calendar years 1935 and 1936, was not taxable as a life insurance company within the meaning of Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711), and (d) that there was a deficiency in income taxes due from petitioner during said calendar years.

(7) The Court erred in holding (R. 188) that, although petitioner's unearned premium account was set up as a matter of "protective business prudence," and although it is and was purely a matter of solvency, set up to prevent the impairment of the company (R. 173); that said unearned premium account was a reserve within the meaning of the term "total reserve funds" as used in Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711).

(8) The court erred in holding that although Congress in enacting Section 201 (a) of the Revenue Acts of 1934 and 1936 stated the measure or rule in determining the character of an insurance company for income tax purposes should be the proportion of its reserves held for the fulfillment of life contracts as against the proportion of its reserves held for the fulfillment of other insurance contracts, that Congress really intended to state that the character of an insurance company for in-

come tax purposes should be determined by the proportion of its premium income received either from life insurance contracts or from health and accident contracts.

E.

SUMMARY OF THE ARGUMENT.

I.

The opinion below in ruling (R. 189) that petitioner's unearned premium account, although not required by law, *i. e.*, by "express statutory provisions or by rules and regulations of the insurance department of the State of Missouri promulgated in the exercise of a power conferred by statute" (R. 27), and although it was not held for the fulfillment of petitioner's health and accident coverage, was a "reserve fund" within the meaning of the term "total reserve funds" in Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711), the Circuit Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this court, namely:

Maryland Casualty Co. v. *United States*, 251 U. S. 342, 350, 40 S. Ct. 155, 64 L. Ed. 297;

Helvering v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, 690, 55 S. Ct. 572, 79 L. Ed. 1227, 1230;

McCoach v. *Insurance Co. of North America*, 244 U. S. 585, 589, 37 S. Ct. 709, 61 L. Ed. 1333, 1336;

United States v. *Boston Insurance Co.*, 269 U. S. 187, 46 S. Ct. 97, 70 L. Ed. 232;

New York Life Insurance Co. v. *Edwards*, 271 U. S. 109, 119, 46 S. Ct. 436, 70 L. Ed. 859, 863;

and has rendered a decision in a way probably in conflict with decisions of other Circuit Courts of Appeal on the same matter, namely:

> *Commissioner of Internal Revenue* v. *Monarch Life Insurance Co.*, (1 C. C. A.) 114 F. 2d 314, 319;

and with the United States Court of Claims, namely:

> *Continental Insurance, Inc.*, v. *United States*, (Ct. Cl.) 8 Fed. Supp. 474, 478;

or if, contrary to the contention of petitioner, the ruling below is not literally in conflict with the foregoing decisions, it presents an important question of federal law which should be settled by this court.

II.

The opinion below in ruling that the term "total reserve funds" within the meaning of Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711) contemplates all reserves or funds of any kind or character set aside as a matter of solvency or protective business prudence and set up as a liability of petitioner, even though such reserves or funds bear no relation to insurance, are not "required by law," and are not held for the fulfillment of any insurance contract. The Circuit Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this court, namely:

> *Helvering* v. *Illinois Life Insurance Co.*, 299 U. S. 88, 57 S. Ct. 63, 81 L. Ed. 56;
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> *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, 55 S. Ct. 572, 79 L. Ed. 1227;

and in conflict with decisions of other Circuit Courts of Appeal, namely:

> *Lamana-Panno-Fallo Industrial Insurance Co., Inc.*, v. *Commissioner of Internal Revenue*, (5 C. C. A.) 127 F. 2d 56, 59.

III.

The opinion below in construing Section 201 (a) of the Revenue Acts of 1934 (48 Stat. 680, 731) and 1936 (49 Stat. 1648, 1710, 1711) disregarded the plain, unambiguous terms used by Congress and substituted for the measure therein contained (proportionate amounts of reserves), its own judgment that the measure should be the proportionate amounts of premium income received from the two types of insurance business done by an insurance company, thereby encroaching upon the legislative power of Congress and deciding an important question of federal law in a way probably in conflict with an applicable decision of this court, namely:

> *Crooks* v. *Harrelson*, 282 U. S. 55, 63, 75 L. Ed. 156, 177.

and in other courts of appeal:

> *Forstmann* v. *Rogers*, (3 C. C. A.) 128 F. 2d 126.

F.

ARGUMENT.

I.

Petitioner contends that the opinion below is in conflict with the plain, unambiguous language of applicable decisions of this court in its construction and interpretation of the meaning of the term "total reserve funds" as used in Section 201 (a) of the Revenue Acts of 1934 and 1936.

In identical language Section 201 (a) in the Revenue Acts of both 1934 and 1936 provides:

> "Definition. When used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health and accident), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 percentum of its total reserve funds."

The term reserve funds has been given and should be given its plain, ordinary meaning, as in *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 350, 40 S. Ct. 155, 64 L. Ed. 297, 302, the court said:

> "The term 'reserve' or 'reserves' has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which, with accretions from interest, is set aside, 'reserved,' as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment."
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> "Reserves, as we have seen, are funds set apart as a liability in the accounts of a company to provide for the payment or reinsurance of specific, contingent lia-

bilities. They are held not only as security for the payment of claims, but also as funds from which payments are made."

Section 201 (a) in its entirety deals with technical insurance reserves, *New World Life Insurance Co.* v. *United States,* (Ct. Cl.) 26 Fed. Supp. 444. While the opinion below cited the above case and quoted a phrase purely dictum, that "Section 201 (a) was enacted for the purpose of taxing insurance companies according to the predominant kind of insurance issued by then," such statement is not shown to have any foundation. That court said, l. c. 462, in speaking of Section 201 (a):

> "This section was dealing only with technical insurance reserves, rather than with the total of such reserves plus reserves for pure liabilities."

"Reserves" as used in one section has the same meaning as "reserves" used in another section, and the term "reserve funds" used in one section must have its plain, ordinary meaning when used in another section. Thus in *Lamana-Panno-Fallo Industrial Insurance Co., Inc.*, v. *Commissioner of Internal Revenue,* (5 C. C. A.) 127 F. 2d 56, the court said, l. c. 58:

> "The tax officer is bound to see that the deduction claimed is based on reserves 'required by law,' as contrasted with voluntary reserves sought to be used as a basis of deduction. He is also concerned to examine the reserves under Section 201 to be sure the taxpayer is a life insurance company at all, for that section defines a life insurance company as one whose reserve funds held for the fulfillment of its life insurance and annuity contracts comprise more than 50 percentum of its total reserve funds. The company, if doing other business than life insurance and annuity, and setting up reserves for this other business, must have the major portion of its reserves held for its life insurance and annuity contracts, in order to be taxed as a life insurance company. The regulation, article 201, very reasonably imports from Section 203 the qualification 'required by law,' so that

> a voluntary increase in those reserves can not be used to make into a life insurance company a company which otherwise would not be such."

As thus seen the term "total reserve funds" means technical insurance reserves, reserve funds required by law. It cannot mean some asset of a company set aside for a particular purpose such as solvency, not pertaining to insurance, but set up to meet some other liability.

The court below has disregarded all of the definitions of "reserves" and "reserve funds" in decisions of this court and other courts of appeal, and has attempted to include within the term "total reserve funds" any and all assets held by a company against any liability, even though such liability is not a future unaccrued contingent liability but is a definite and accrued liability. It is submitted that for this reason alone this court should grant certiorari upon the obvious conflict with applicable decisions of this court and other courts of appeal, and unless the opinion below is reviewed by this court the meaning of Section 201 (a) of the Revenue Acts of 1934 and 1936 will be undetermined.

II.

The gist of the opinion below is that all of the assets of an insurance company maintained as a matter of protective business prudence, possible competitive purposes (R. 189), set up on generally established business and accepted standards for conducting the business, are reserve funds within the meaning of the term "total reserve funds" of Section 201 (a). This holding is plainly in conflict with the case of *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686-690, 79 L. Ed. 1227, 1230, decided by this court April 1, 1935, wherein it was stated:

> "* * * 'Reserve funds' may not reasonably be deemed to include values that do not pertain directly to insurance."

and in conflict with *Helvering* v. *Illinois Life Insurance Co.*, 299 U. S. 88, 57 S. Ct. 63, 81 L. Ed. 56, wherein the court stated, l. c. 90:

> "The phrase 'required by law' includes only reserves that directly pertain to life insurance. Other reserves, even though required by state statutes regulatory to the business authorized to be carried on by life insurance companies, are not included."

It has been shown that the term "total reserve funds" as used in Section 201 (a) of the Revenue Acts of 1934 and 1936 contemplate reserves required by law, technical insurance reserves, or those directly pertaining to insurance; that it does not contemplate reserves or reserve fund or funds held to meet other liabilities; that it does not include solvency reserves.

The petitioner's unearned premium account was set up purely as a matter of solvency. It was a "voluntary reserve." *Lamana-Panno-Fallo Industrial Insurance Co., Inc.*, v. *Commissioner of Internal Revenue*, (5 C. C. A.) 127 F. 2d 56, 59. It was not required by law, was not a technical insurance reserve, did not pertain directly or indirectly to insurance, was set up (R. 43) from which to repay the unearned premium to policy holders upon cancellation. In the case of *New World Life Insurance Co.* v. *United States*, 26 F. Supp. 444, 466, the court said, l. c. 462:

> "If the term 'total reserve funds' refers to and includes the company's total *liabilities* for which all state laws require insurance companies to hold reserves, the definition would be rendered useless."

To the same effect *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109-121, 70 L. Ed. 859, 863, the court said, l. c. 120:

> "The term 'reserve funds' in the taxing act has a technical meaning. The compensation which an insurance company agrees to pay soliciting agents

> has no relation to the reserve held to meet maturing policies; and when it sets aside a fund to provide payments to such agents this cannot be regarded as a reserve within intendment of the statute."

The fact that the fund was designated as "unearned premium reserve" by the Missouri Superintendent of Insurance is no indication of the character of the fund. *McCoach* v. *Insurance Co. of N. A.*, 244 U. S. 585, 61 L. Ed. 1333, 37 S. Ct. 709.

III.

Congress in enacting Section 201 (a) of the Revenue Acts of 1934 and 1936 plainly and clearly stated that a company for income tax purposes would be considered a life company if the reserves held for the fulfillment of life contracts comprised more than 50 percentum of its total reserve funds. Congress did not state that if more than 50 percent of a company's premium income was derived from health and accident business that it could not be taxed as a life company. It did not provide that if more than 50 percent of its premium income was derived from life business that it would be a life company. Had Congress intended to say that the measure by which a life insurance company would be classified would be the proportionate amount of its premium income Congress could plainly have so provided. It did not. The court in its construction of Section 201 (a) has substituted words not contained in the statute by enlarging and broadening the meaning of the term "total reserve funds" to encompass any and all assets set aside to meet any liability of an insurance company, seizing upon that phrase contained in the opinion in the case of *New World Life Insurance Company* v. *United States*, that "Section 201 (a) quoted above was enacted for the purpose of taxing insurance companies according to the predominant kind of insurance issued by them." This means premium income. As was so aptly stated by this court in the case of *Crooks* v. *Harrelson*, 282 U. S. 55, 63, 75 L. Ed. 156, 177, at l. c. 60:

"Courts have sometimes exercised a high degree of ingenuity in the effort to find justification for wrenching from the words of the statute a meaning which they literally did not bear in order to escape consequences thought to be absurd or to entail great hardship. But an application of the principle so nearly approaches the boundary between the exercise of the judicial power and that of the legislative power as to call rather for great caution and circumspection in order to avoid usurpation of the latter. *Monson* v. *Chester*, 22 Pick. 385, 387. It is not enough merely that hard and objectionable or absurd consequences, which probably were not within the contemplation of the framers, are produced by an act of legislation. Laws enacted with good intention, when put to the test, frequently, and to the surprise of the law maker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law-making authority and not with the courts."

And in *Forstmann* v. *Rogers*, (3 C. C. A.) 128 F. 2d 126, at l. c. 129, the court summed up the same situation in the following language:

"The task of a judge called upon to construe a statute is frequently a difficult and delicate one. It is distasteful to him to have to hold that the legislative branch has failed to include in a statute a provision obviously desirable. It is much easier for him to yield to the temptation to supply the omission by doing a little legislating himself under the guise of construing the statute. The temptation is particularly great where, as here, it is quite likely that the legislature would have provided for the case if it had thought of it and where, as here also, the public revenues suffer by the omission. But judges must set themselves firmly against such action in a case such as this where to do so would involve rewriting the statute, not construing it. Under our constitutional arrangements such an amendment is solely within the Congressional province and completely outside the judicial sphere. An encroachment by the judiciary upon the legislative power may, in a case such as this, be ap-

> plauded at the moment as a saving of legislative time and public revenue, but it must be resisted the more stoutly since as a usurpation of power, even though well intentioned, it carries within itself the seeds of future tyranny."

The court below rewrote Section 201 (a). The opinion writes Section 201 (a) to read: "the character of an insurance company shall be determined by the proportionate amount of its premium income derived from its life insurance coverage or its coverage on health and accident insurance," and we submit with all respect that the court below has succumbed to the temptation to "do a little legislating itself" and to substitute for the judgment of Congress its judgment. The manner in which the court decided this cause was directly and plainly in conflict with the rule laid down in the above cases.

Conclusion.

Petitioner respectfully submits that the rulings contained in the opinion below are plainly in conflict with applicable decisions of this court and with decisions of other courts of appeal. The question presented and the rulings of the court of appeals upon that question are of grave public importance. Unless the opinion below is reviewed, the law relating to the definition and classification of life insurance companies for income tax purposes as measured by their "reserve funds" will be left in confusion and chaos. The question, one of fundamental importance, should in the public interest be determined by this court, and the orderly administration of justice can only be subserved by the review sought by petitioner.

Respectfully submitted,

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